FILE COPY

Office - Supreme Court, U. S.
FILED
MAY 23 1944
CHARLES ELMORE CROPLEY
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No. 1026[illegible] 93

W. G. CHOATE, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

COMMISSIONER OF INTERNAL REVENUE, *Cross-Petitioner*,

v.

W. G. CHOATE, *Cross-Respondent*

PETITION FOR WRITS OF CERTIORARI

to the United States Circuit Court of Appeals
For the Tenth Circuit

JAMES H. YEATMAN,
CHARLES I. FRANCIS,
Attorneys for Petitioner,
Esperson Bldg.,
Houston, Texas

Of Counsel:
VINSON, ELKINS, WEEMS & FRANCIS,
Esperson Bldg.,
Houston, Texas

ALPHA LAW BRIEF CO. HOUSTON

INDEX

	PAGE
Opinions Below	2
Jurisdiction	2
Questions Presented	2
Statutes Involved	3
Statement	3
Specification of Errors to Be Urged	6
Reasons Relied on For the Allowance of the Writ	6
Appendix	14

CITATIONS

PAGE

CASES

Bonwit Teller & Co. v. U. S., 283 U.S. 258 12
Bowers v. New York & Albany Lighterage Co., 213 U.S. 346 12
Burnett v. Harmel, 287 U.S. 103 12
Burnett v. Niagara Falls Brewing Co., 282 U.S. 648 12
Butler v. Thomson, 92 U.S. 412 10
Columbia Oil & Gas Co. v. Commissioner, 118 Fed. (2d) 459 7
Commissioner v. A. & P. Production Co., 122 Fed. (2d) 459 7
Commissioner v. American Liberty Oil Co., 127 Fed. (2d) 262 7
Commissioner v. Lewis, 132 Fed. (2d) 709 7, 9
Commissioner v. McAlbert Oil Co., Inc., 122 Fed. (2d) 192
Commissioner v. Roeser & Pendleton, Inc., 118 Fed. (2d) 462 9
Cullen v. Commissioner, 118 Fed. (2d) 651 9
Fleming v. Commissioner, 82 Fed. (2d) 324 9
Griffiths v. Helvering, 308 U.S. 355 10
Helvering v. Tex-Penn Oil Co., 300 U.S. 481 10
Hogan v. Commissioner, 141 Fed. (2d) 92 5
Lee v. Commissioner, 126 Fed. (2d) 825 9
McLean v. Commissioner, 120 Fed. (2d) 942 9
Roeser & Pendleton, Inc., v. Commissioner, 118 Fed. (2d) 462 9
Sheppard, et al., v. Stanolind Oil & Gas Co., 125 S.W. (2d) 643 9
Smith v. Higgins, 308 U.S. 651 10
State, et al., v. Quintana Petroleum Corp. (Sup. Ct. of Tex.); 134 Tex. 179, 133 S.W. (2d) 112 9
Thomas v. Perkins, 301 U.S. 655 11
U. S. v. Merriam, 263 U.S. 179 12
U. S. v. Phellis, 257 U.S. 156 10
U. S. v. Updyke, 281 U.S. 489 12
West Production Co. v. Commissioner, 121 Fed. (2d) 9 9

STATUTES

	PAGE
Revenue Act of 1938:	
Sec. 22(a)	14
Sec. 23(1) and (m)	14
Sec. 111	15
Sec. 114(b) (3)	15
Sec. 117(a) (1)	16
(a) (4)	16
(b)	16

MISCELLANEOUS

Excerpt From House Report No. 350 Ways and Means Committee on the Revenue Act of 1921	16

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No.

W. G. CHOATE, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

COMMISSIONER OF INTERNAL REVENUE, *Cross-Petitioner*,

v.

W. G. CHOATE, *Cross-Respondent*

PETITION FOR WRITS OF CERTIORARI

to the United States Circuit Court of Appeals For the Tenth Circuit

TO THE HONORABLE THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The petitioner, W. G. Choate, prays that a writ of certiorari issue to review the decision and judgment of the United States Circuit Court of Appeals for the Tenth Circuit entered March 13, 1944, in the case of W. G. Choate, Petitioner, v. Commissioner of Internal Revenue, Respondent, and Commissioner of Internal Revenue, Cross-Petitioner, v. W. G. Choate, Cross-Respondent, Nos. 2789 and 2790 (R. pp. 79-84).

Opinions Below

The Memorandum Opinion of The Tax Court of the United States (R. 24-34) is unreported. The Opinion of the Circuit Court of Appeals is reported at — Fed. (2d) — (C.C.A. 10th, March 13, 1944), and appears on pages 79 to 84 of the record.

Jurisdiction

The jurisdiction of this Court is invoked under Section 240(a) of the JUDICIAL CODE as amended by the Act of February 13, 1925. The judgment of the Circuit Court of Appeals was entered March 13, 1944. A petition for rehearing was filed within twenty (20) days after entry of the judgment and was denied April 8, 1944 (R. p. 94).

Questions Presented

1. Where an interest in an oil and gas lease is assigned for a cash consideration with the assignor retaining and not selling 1/8th of 8/8ths of all oil and gas produced and saved from the premises, is the transfer a sale and the profit taxable as long-term capital gain under Section 117 of the REVENUE ACT OF 1938 (App. p. 16), or is it a sublease and the profit taxable as ordinary income under Section 22(a) of the Act? (App. p. 14.)

2. Where title to the equipment on the lease passes to the assignee absolutely without any interest therein being reserved to the assignor, is the unrecovered cost of the equipment deductible from the cash consideration in computing the gain, or must it be recovered through depletion allowance applicable to the production from the retained interest in the oil reserves?

Statute and Regulations Involved

The Statute and Regulations involved will be found in the Appendix, infra, pp. 14 to 17.

Statement

This is a companion case with Hogan v. Commissioner and Commissioner v. Hogan, 141 Fed. (2d) 92 (C.C.A. 5th, Feb. 25, 1944), which is in direct conflict with this case on one point.

On December 18, 1936, Fred T. Hogan and L. H. Choate, acting for themselves and W. G. Choate, the petitioner herein, acquired an oil and gas lease by assignment from one Roy R. Brown. The lease had been originally executed by Mrs. M. L. Baker, the fee owner, and covered a tract of land situated in Upton County, Texas. After the lease was acquired from Brown, a partnership was formed under the name of Choate & Hogan to own, develop and operate the property for the production of oil and gas. Petitioner owned a one-fourth interest in said partnership. Subsequently, the partnership developed the Baker lease by drilling six producing oil wells thereon. Said wells were completed prior to October 11, 1938. On the latter date, Choate and Hogan, acting for the partnership, entered into a written contract (R. 69) to sell an interest in the lease to McAlester Fuel Company for a cash consideration of $110,000.00 to be paid by the buyer; and the contract further provided that the sellers were to except and reserve to themselves, their heirs and assigns, an overriding royalty of 1/8th of 8/8ths of all oil and gas produced and saved from the lease by the buyer. On August 22, 1938, Choate & Hogan executed an assignment (R. 18) of the lease, together with all the equipment thereon, to the Sylva Oil Company (nominee of McAlester Fuel Company, R. 73), and in said assignment it was provided, among other

things, that "assignors herein expressly reserve to themselves, their heirs and assigns, and *do not assign or convey* to the assignee herein, 1/8th of 8/8ths of all oil and gas and casinghead gas which may be produced and saved by the Sylva Oil Company."

In the partnership return filed by Choate & Hogan for the year 1938, the profit from the sale of the interest in the lease was reported as long-term capital gain pursuant to Section 117 of the REVENUE ACT OF 1938. The respondent determined that the transaction with the Sylva Oil Company was a sublease rather than the sale of a capital asset and that the profit could not be treated as a long-term capital gain. He treated the cash consideration of $110,000.00 as a lease bonus, allowed depletion thereon at the rate of 27½% (Section 114(b) (3), App. p. 15) of the REVENUE ACT OF 1938), and taxed the remainder as ordinary income. (Section 22 (a) of the Act. App. p. 14.)

In his computation, respondent made no allowance for the undepreciated cost of the equipment ($23,090.60) which was on the lease at the time of the sale, and held that such undepreciated cost was recoverable through depletion allowances applicable to production from the retained interest of 1/8th of 8/8ths.

The Tax Court held (1) that the petitioner was not entitled to treat the transfer of the interest in the lease as a sale, but must look to depletion for the return of his capital; and (2) that the unrecovered cost of the equipment on the lease at the time of the transfer is to be deducted in full from the cash consideration in determining the amount of the gain subject to the depletion allowance (R. 24-34).

Both the petitioner and the Commissioner appealed and the Tenth Circuit Court of Appeals sustained The Tax Court's decision on the first point and reversed its decision on the second point. The Fifth Circuit Court of Appeals in the com-

panion cases of Fred T. Hogan v. Commissioner and Commissioner v. Fred T. Hogan, 141 Fed. (2d) 92, affirmed the decision of The Tax Court on both points.

Specifications of Error to Be Urged

1. The court below erred in holding that petitioner did not make a sale of an interest in the Baker lease and that for taxation purposes his interest is determined by depletion.

2. The court below erred in holding that the undepreciated cost of the equipment is not deductible from the cash consideration of $110,000.00 but is to be returned through depletion allowances applicable to production from the retained interest.

Reasons Relied Upon for the Allowance of the Writ

FIRST. There is a direct conflict between the decision of the Tenth Circuit in this case and the Fifth Circuit in the companion case of COMMISSIONER V. HOGAN, supra, on the second point. The Fifth Circuit Court held that in computing the net gain realized on the transfer, the unrecovered cost of the lease equipment is deductible from the cash consideration of $110,000.00 received for the property. The Tenth Circuit Court held that the unrecovered cost of the lease equipment is not so deductible and that same must be recovered through depletion allowances. There is, therefore, a clear conflict in the decisions of the two Circuit Courts of Appeal on the tax liability of members of the same partnership and arising out of the same transaction.

The decision of the Tenth Circuit Court of Appeals on the equipment issue is clearly erroneous and should be reversed. Petitioner disposed of all his right, title and interest in the lease equipment and retained no interest whatever therein. The leasehold equipment is depreciable property. The cost of depreciable property is recoverable only in one

or two ways; first, through annual allowances for depreciation (Sec. 23 (m), Appendix p. 14), and secondly as an offset against the selling price if the property is sold or exchanged (Sec. 111 (a), Appendix p. 15). The cost of depreciable property cannot lawfully be recovered by way of depletion allowances either under Sec. 23(1) or (m), or Sec. 114(b) (3), Appendix p. 15). The purpose of these provisions is to compensate the owner of the oil, gas or other minerals for the quantity which is exhausted or dissipated by production. Said provisions have no reasonable relation to the exhaustion, wear and tear of the machinery used to produce the minerals and the cost of the machinery is not recoverable thereunder, and unless petitioner is permitted to deduct the cost of his equipment from the cash consideration received from the sale said cost will never be returned to him.

The Fifth and Tenth Circuit Courts of Appeal have uniformly held that the full cost of the equipment is deductible when the sale is for cash and an oil payment is retained by the vendor. COMMISSIONER v. A. & P. PRODUCTION CO., 122 Fed. (2d) 192; COMMISSIONER v. MCALBERT OIL CO., INC., 122 Fed. (2d) 192; COMMISSIONER v. AMERICAN LIBERTY OIL CO., 127 Fed. (2d) 262; COMMISSIONER v. ROESER & PENDLETON, INC., 118 Fed. (2d) 462; COLUMBIA OIL & GAS CO. v. COMMISSIONER, 118 Fed. (2d) 459 (all by C.C.A. 5th), and COMMISSIONER v. LEWIS, 132 Fed. (2d) 709, (C.C.A. 10th). As hereinafter shown, there is no difference in quality or character between an oil payment and an overriding royalty.

The Tenth and Fifth Circuit Courts of Appeal each held that the taxpayer is not entitled to treat the transfer of the interest in the lease itself as a sale and the resulting profit as long-term capital gain. On this point, both courts held that the taxpayer's rights are determinable by depletion. The in-

terest in the lease and the equipment were disposed of as a unit in a single transaction. By the terms of the sales contract, the partnership agreed to sell an interest in the lease, together with all equipment on the lease and title to the interest in the lease and the equipment was conveyed by a single instrument of conveyance. Should this Court undertake to review the decision of the Tenth Circuit Court on the equipment issue, as to which the conflict exists, it will be necessary for it to examine both the contract of sale and the assignment, and no additional burden will be imposed on the Court if it also undertakes to review said decision on the issue as to whether the transaction was a sale or a sublease. Furthermore, as hereinafter pointed out, this question is of first importance to the oil industry as a whole. For these reasons we respectfully urge the Court to grant this petition and review the decision of the Tenth Circuit Court of Appeals in its entirety.

SECOND. Approximately sixty-five percent of the known oil reserves of the United States are located in the States of Texas, Louisiana and Mississippi, which States are included within the Fifth Judicial Circuit of the United States. There are also substantial oil reserves in certain of the States embraced within the Tenth Circuit, such as Oklahoma, New Mexico and Colorado. Assignments of oil and gas leases are made in said States practically every day in the year. A customary practice in the industry is for the assignee to pay the assignor a cash consideration, with the assignor retaining an overriding royalty or an oil payment in a certain amount payable out of a fraction of the production. An important question of federal law which has not been, but should be settled by this Court, arises in the case of each of such assignments, namely, for federal tax purposes, are transactions of such character sales of capital assets, and do they give rise to capital gains or losses which are limited by Section 117 of

the REVENUE ACT of 1938, or are they so-called subleases, the gain and loss on which is recognizable in full for federal tax purposes? The Fifth Circuit Court has arbitrarily held that the transaction is a sale if an oil payment is retained by the vendor, but that it is a sublease where the retained interest is stated in terms of an overriding royalty. CULLEN v. COMMISSIONER, 118 Fed. (2d) 651; WEST PRODUCTION CO. v. COMMISSIONER, 121 Fed. (2d) 9; MCLEAN v. COMMISSIONER, 120 Fed. (2d) 942; FLEMING v. COMMISSIONER, 82 Fed. (2d) 324; ROESER & PENDLETON, INC. v. COMMISSIONER, 118 Fed. (2d) 462 (all by C.C.A. 5th). The Tenth Circuit Court of Appeals has made the same distinction, Commissioner v. Lewis, 132 Fed. (2d) 709, and CHOATE v. COMMISSIONER, supra (Record 79). These rulings have been made notwithstanding it is the settled law of Texas that an oil payment and an overriding royalty are each real property of like kind and character. STATE, ET AL., v. QUINTANA PETROLEUM CORP., ET AL. (Supreme Ct. of Texas), 134 Tex. 179, 133 S.W. (2d) 112; SHEPPARD, ET AL., v. STANOLIND OIL & GAS CO. (Austin Ct. of Civil Appeals, writ of error refused), 125 S.W. (2d) 643. Thus the distinction made by the Fifth and Tenth Circuit Courts between an oil payment and an overriding royalty is a distinction without a difference. See also LEE v. COMMISSIONER, 126 Fed. (2d) 825, where the Fifth Circuit Court held that oil payments and overriding royalties are to be treated alike for depletion purposes.

The effect of the decisions of the Fifth and Tenth Circuits has been to deprive taxpayers of the special benefits accorded them by the statutes relating to taxation of capital gains, which statutes were intended to be and are remedial in character. Under the said decisions, a taxpayer cannot make a sale of an oil and gas lease and secure taxation of the gain at capital gain rates if he retains an interest in the form of an

overriding royalty, and this is true notwithstanding every essential element of a sale is present in the transaction, namely: (1) Parties competent to contract; (2) mutual assent; (3) a thing, the absolute or general property in which is transferred from the seller to the buyer; and (4) a price in money paid or promised. (BUTLER v. THOMSON, 92 U.S. 412.) Thus, the question is of the utmost importance to the vast number of taxpayers who own oil and gas leases. The question is also important from the standpoint of the Treasury because under the decisions of the Fifth and Tenth Circuits, as they now stand, a taxpayer owning an oil and gas lease can effect a transfer of it in a manner which will permit him to control the amount of gain or loss thereon which will be recognizable for tax purposes. This Court should, therefore, review the decision of the Tenth Circuit Court of Appeals herein in its entirety in order that a rule of law may be established which will be applicable in all cases, whether an overriding royalty or an oil payment is retained by the assignor.

THIRD. This Court has affirmed the doctrine that in tax matters substance always controls over form. U. S. v. PHELLIS, 257 U.S. 156; HELVERING v. TEX-PENN OIL CO., 300 U.S. 481; SMITH v. HIGGINS, 308 U.S. 561; and GRIFFITHS v. HELVERING, 308 U.S. 355. The Circuit Court of Appeals for the Fifth and Tenth Circuits in the cases cited supra applied an arbitrary rule of thumb or yardstick in determining whether the transactions were sales or subleases. If the reservation was in the form of an oil payment, the transaction was held to be a sale; if stated in terms of an overriding royalty, the transfer was held to be a sublease. Thus, the decisions were made to turn entirely and exclusively on the type of reservation that was contained in the instrument of conveyance. Form and form alone has been the dominating and decisive guidepost followed in rendering the said decis-

ions and judgments. The type of reservation has been applied as an all-exclusive test in determining the nature of the transaction. Proof of this fact is ably demonstrated by the incongruous results reached by the Fifth Circuit Court in CULLEN's case where, despite the fact that the twelve leases were conveyed by a single instrument in a single transaction, it was held as to the nine leases in which overriding royalties were retained that the transfers were subleases, and as to the three leases in which oil payments were retained that the transfers were sales. The court below has given no heed whatever to the substance of what was done. Accordingly, its decision and judgment conflict in principle with the settled law established by this Court that in applying our tax laws the courts will not exalt form over substance.

FOURTH. The decision of the court below is also believed to be in conflict in principle with the decision of this Court in THOMAS v. PERKINS, 301 U.S. 655. In such case, an oil and gas lease was conveyed to the taxpayer for a cash consideration plus a sum to be paid out of the oil produced and saved from the lands. The Collector sought to tax the assignee with the amounts paid by him over to the assignor on the oil payment. This Court held that the fraction of the oil required to liquidate the oil payment did not pass to the assignee by virtue of the terms of the assignment and that such fraction of the oil reserves had been retained by and belonged to the assignor, and that the assignee was not taxable on the proceeds therefrom. Although this Court did not pass directly on the question of whether the assignor had made a sale of the fraction of the oil that passed to the assignee, it did recognize that a taxpayer owning an oil and gas lease can make a sale of a fractional interest therein and retain a fractional interest. The court below has refused to treat and recognize as a sale a transfer of a lease if an overriding royalty is retained by the transferor and its decision

is probably in conflict with the decision of this Court in THOMAS v. PERKINS, supra.

FIFTH. Before the Revenue Act of 1921 gains realized from the sale of property were taxed at the same rates as other income with the result that capital gains often accruing over a long period of time were taxed in the year of realization at the high rates resulting from their inclusion in the higher surtax brackets. The provision of the 1921 Revenue Act for taxing capital gains at a lower rate, reënacted in one form or another in all subsequent Revenue Acts, were *"adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments and to remove the deterrent effect of those burdens on such conversions."* BURNETT v. HARMEL, 287 U.S. 103, and HOUSE REPORT NO. 350, WAYS AND MEANS COMMITTEE, 67th Congress, First Session, on the Revenue Bill of 1921 (App. p. 16).

It is clear from this Court's decision in the HARMEL case and the Report of the Committee on Ways and Means that the new provision of the Revenue Act of 1921 taxing capital gains at a lower rate than ordinary income was taxed was intended as a relief measure. This Court has repeatedly held that relief statutes are to be construed liberally in favor of taxpayers in order that they will receive the benefit of the relief the statutes were intended to provide. BONWIT TELLER & Co. v. U. S., 283 U.S. 258; U. S. v. MERRIAM, 263 U.S. 179; BOWERS v. NEW YORK & ALBANY LIGHTERAGE CO., 213 U.S. 346; U. S. v. UPDYKE, 281 U.S. 489; and BURNETT v. NIAGARA FALLS BREWING CO., 282 U.S. 648.

The gain involved in this proceeding resulted from the conversion of a capital asset, namely: an interest in an oil and gas lease on which there were six producing oil wells at the time of the transfer. The lease had been held by the partnership for the requisite length of time for the gain on the

transfer to be taxed as long-term capital gain. All of the gain did not accumulate in the year of realization. It accrued over the period of time the lease was held and owned by the partnership. If the gain is treated as ordinary income, 100% of it will be taxable; whereas, if it is treated as long-term capital gain, only 60% will be includible in income. If the gain is treated as ordinary income, it will fall in a higher surtax bracket than it would if treated as long-term capital gain; consequently, petitioner is within that class of taxpayers which the capital gain provisions were intended to reach and benefit by relieving them from excessive surtax burdens when a capital asset is converted at a profit.

Notwithstanding the above situation, the court below held that the petitioner was not entitled to *treat* the transaction as a sale. In doing so, the court has not construed the statutes liberally in petitioner's favor. On the contrary, the statute has been construed most liberally in favor of the Government. Thus it appears that the court below has violated the principle long since settled by the decisions of this Court that relief statutes are to be given a liberal construction in favor of taxpayers in order to give them the relief the statutes were intended to provide.

It is respectfully submitted that this petition should be granted on both points.

James F. Coatman
Chas. I. Francis
Attorneys for Petitioner

Appendix

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

(l) DEPRECIATION.—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income of the beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In

any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant.
* * *

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in Section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(b)(3) *Percentage Depletion for Oil and Gas Wells.*—In the case of oil and gas wells the allowance for depletion under Section 23(m) shall be 27½ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under Section 23(m) be less than it would be if computed without reference to this paragraph.

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) (1) *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in Section 23 (l).

(a) (4) *Long-Term Capital Gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income.

(b) *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for more than 18 months but not for more than 24 months;

66 2/3 per centum if the capital asset has been held for more than 18 months but not for more than 24 months;

50 per centum if the capital asset has been held for more than 24 months.

HOUSE REPORT NO. 350. WAYS AND MEANS COMMITTEE ON THE REVENUE ACT OF 1921.

"The sale of farms, mineral properties, and other capital assets is now seriously retarded by the fact that gains and profits earned over a series of years are under the present law taxed as a lump sum (and the amount of

surtax greatly enhanced thereby) in the year in which the profit is realized. Many such sales, with their possible profit taking and consequent increase of the tax revenue, have been blocked by this feature of the present law. In order to permit such transaction to go forward without fear of a prohibitive tax, the proposed bill, in Section 206, adds a new section (207) to the income tax, providing that where the net gain derived from the sale or other disposition of capital assets would, under the ordinary procedure, be subjected to an income tax in excess of 15 per cent, the tax upon capital net gain shall be limited to that rate. It is believed that the passage of this provision would materially increase the revenue, not only because it would stimulate profit-taking transactions but because the limitation of 15 per cent is also applied to capital losses. Under present conditions there are likely to be more losses than gains."